No. 7736

In the United States Circuit Court of Appeals for the Ninth Circuit

COMMISSIONER OF INTERNAL REVENUE, PETITIONER

v.

HOPE C. NEAVES, RESPONDENT

ON PETITION FOR REVIEW OF DECISION OF THE UNITED STATES BOARD OF TAX APPEALS

BRIEF FOR THE PETITIONER

FRANK J. WIDEMAN,
Assistant Attorney General.

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LUCIUS A. BUCK,
Special Assistants to the Attorney General.

FILED

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CITATIONS

23006—35——1

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OPINION BELOW

The only previous opinion in this case is that of the United States Board of Tax Appeals (R. 15–18) which is unreported.

JURISDICTION

This case involves a deficiency in income taxes in the sum of $1,244.19 for the year 1928 (R. 15). This appeal is taken from a decision of the Board of Tax Appeals, promulgated May 16, 1934 (R. 18–19), and an order entered July 26, 1934 (R. 21), denying a motion for reconsideration and to vacate the decision (R. 19–21). The case is brought to this Court by a petition for review filed October 12, 1934 (R. 28), pursuant to the provisions of Sections 1001–1003 of the Revenue Act of 1926, c. 27, 44 Stat. 9, 109–110, as amended by Section 1101 of the Revenue Act of 1932, c. 209, 47 Stat. 169.

QUESTION PRESENTED

In the latter part of the year 1928 taxpayer sold certain stock to her father. In May 1929 taxpayer repurchased the stock. The entire transaction was handled by her brother, who represented her under a power of attorney. Was the taxpayer entitled to a deductible loss on this transaction?

STATUTES AND REGULATIONS INVOLVED

The statutes and regulations involved are set forth in the Appendix, *infra*, pp. 11–13.

STATEMENT

The only witness in this case before the Board was the taxpayer (R. 30–33). The facts as found by the Board (R. 15–16) are substantially as follows: The Commissioner determined a deficiency in income tax against the taxpayer for the calendar year 1928 in the amount of $1,244.19. In her return for that year the taxpayer claimed a loss of $1,360 on the sale of common stock of United Wire & Supply Company, and a capital net loss of $8,455 on the sale of preferred stock of the same company.

These claimed losses were disallowed by the Commissioner, and the only question for decision is whether such disallowance was proper.

It appears that in 1928 taxpayer was the owner of 80 shares of common stock of United Wire & Supply Company, which had been acquired December 29, 1926, at a cost of $1,600, and 150 shares of preferred stock of said company acquired in 1917 by gift from her father which stock had a cost of $15,000. The taxpayer, a resident of California, kept the stock in a safe deposit box in Providence, Rhode Island, to which her brother, who acted for her in busines transactions under a power of attorney, had access. In the latter part of 1928 the taxpayer was advised by her brother to sell the 80 shares of common stock and 150 shares of preferred stock of United Wire & Supply Company, to which she assented, but she had no knowledge to whom the stock was to be sold. On December 18, 1928, taxpayer's said brother sold the stock to taxpayer's father, receiving therefor $240 for the 80 shares of common stock and $6,545 for the 150 shares of preferred stock, and said amounts were paid to taxpayer by check of her father in the amount of $6,785 and deposited to taxpayer's account in the Phenix National Bank of Providence, Rhode Island.

There was no agreement or understanding between taxpayer and any other person that she could or would purchase said stock or any part thereof, and the said sale price of $6,785 represented the prevailing market price of the stocks at the time of said sale. The said stock so sold or similar stocks were reacquired by taxpayer in May 1929.

In her income-tax return for 1928 taxpayer claimed a loss of $1,360 on the sale of the 80 shares of common stock, and a capital net loss of $8,455 on the sale of the preferred stock, both of which claims the Commissioner disallowed on the ground that the transaction was not a bona fide sale.

SPECIFICATION OF ERRORS TO BE URGED

The Board of Tax Appeals erred in the following particulars:

1. In not finding and holding that the taxpayer was not entitled to a deductible loss on the alleged sale.

2. In not finding and holding that no *bona fide* sale was made.

3. In not finding and holding that the taxpayer's evidence was insufficient to overcome the *prima facie* presumption in favor of the Commissioner's determination.

4. In not approving and upholding the Commissioner's determination.

5. The assignments of error (R. 25–26) are hereby incorporated by reference in this brief as fully and completely as if set forth at this point *in haec verba*. The ensuing argument is intended to apply to each and every of said assignments jointly and severally.

SUMMARY OF ARGUMENT

In favor of the Commissioner's determination there existed a *prima facie* presumption as to its correctness. The taxpayer had the burden of overcoming this presumption with positive proof. In addition the taxpayer had an added burden of proof because, (a) she was claiming the benefit of a deduction provision of the Revenue Act; (b) the transaction was with members of her family; and (c) the stock was repurchased during the following tax year. The taxpayer's evidence is wholly insufficient to carry her burden of proof. She did not call her brother, who handled the transaction, as a witness, nor did she excuse or explain her failure to do so. She did not call her father, who purchased the stock and later resold it to her, as a witness, nor did she excuse or explain her failure to do so. The taxpayer's own testimony does not show any reason for the sale and repurchase, and does not show the *bona fides* thereof.

ARGUMENT

There exists in favor of the Commissioner's determination a *prima facie* presumption of correctness. *Wickwire* v. *Reinecke,* 275 U. S. 101, 105; *Burnet* v. *Houston,* 283 U. S. 223, 227; *Green's Advertising Agency* v. *Blair,* 31 F. (2d) 96, 98 (C. C. A. 9th). The taxpayer's proof must be sufficient to overcome this presumption. In addition, in this case the taxpayer was claiming the benefit of a deduction. "* * * the burden is upon the taxpayer to establish the amount of a deduction claimed." *Helvering* v. *Taylor,* 293 U. S. 507; *Burnet* v. *Houston, supra; Helvering* v. *Ind. Life Ins. Co.,* 292 U. S. 371, 381. In *New Colonial Co.* v. *Helvering,* 292 U. S. 435, the Court said (p. 440):

> Whether and to what extent deductions shall be allowed depends upon legislative grace; and only as there is clear provision therefor can any particular deduction be allowed.
>
> * * * * *
>
> Obviously, therefore, a taxpayer seeking a deduction must be able to point to an applicable statute and show that he comes within its terms.

We respectfully submit that the taxpayer's evidence (R. 30–33) wholly fails to carry the burden of proof which rested upon her in this proceeding.

In the first place, this was entirely an intrafamily transaction. The taxpayer resides in California (R. 15). The alleged sale was handled by taxpayer's brother in Providence, Rhode Island (R. 31, 32). The brother represented her under a power of attorney (R. 31) and apparently handles her affairs for her (R. 32). The sale was suggested by the brother (R. 31). The brother sold the stock on December 18, 1928 (R. 32). The purchaser was the taxpayer's father (R. 31–32). The taxpayer reacquired the stock in 1929; the brother handled the reacquisition (R. 32). The terms of reacquisition do not appear. It is the well-settled rule that transactions between persons so closely related will be closely scrutinized. Cf. *Slayton* v. *Commissioner,* 76 F. (2d) 497 (C. C. A. 1st). As the Board has said, members of a family "must not play fast and loose with their respective properties to the prejudice of * * * taxes which they properly owe to the Government." *Fouke* v. *Commissioner,* 2 B. T. A. 219; *Schlossberg* v. *Commissioner,* 2 B. T. A. 683; *Hemenway* v. *Commissioner,* 11 B. T. A. 1311. The rule has been applied in close business relationships. Cf. *Rand* v. *Commissioner,* 77 F. (2d) 450 (C. C. A. 8th). The doctrine was applied by this Court to a transaction between directors and their corporation. *Wishon Watson Co.* v. *Commissioner,* 66 F. (2d) 52. Cf. *Commissioner* v. *Riggs* (C. C. A. 3d), decided July 18, 1935, not yet officially reported but may be found in C. C. H. 1935, Vol. 3–A, p. 10271.

Certainly, the rule, in its practical application, requires a full and frank disclosure of all of the details surrounding a tax transaction between a daughter and her father. Such a disclosure does not appear in this record. Here there is nothing more than the bare testimony that the sale was made practically at the end of the tax year and a reacquisition took place sometime during the following year (R. 30–32). The taxpayer assigns no reason for the sale and no reason for its repurchase. It is obvious that she entrusted the whole affair to her brother; she did not know why the sale was made because "He did not explain the reason for the advisability of the sale" (R. 31–32).

In the second place, the taxpayer's evidence is insufficient because she did not produce as a witness the one who handled the sale and reacquisiton for her. In *Slayton* v. *Commisioner, supra,* the court said (p. 499):

> Mrs. Slayton knew little about the business of the Hoyt Shoe Company, except as she was told by her husband. Her transfer of the stock was at his suggestion, and from her testimony he clearly acted as her agent in arranging for the transfer of the shares.

It is also clear that the brother had the power to sell and reacquire under the power of attorney. The facts suggest a plan of reacquisition at the time of sale. If the taxpayer's brother had an understanding for the repurchase of the stock at the time of sale, the case falls within Section 118 of the Revenue Act of 1928 and the loss cannot be recognized. Cf. *Commissioner* v. *Dyer,* 74 F. (2d) 685 (C. C. A. 2d). The brother was the taxpaper's most vital witness on this point; the father was the next most qualified witness. Neither of these witnesses were offered. This failure to produce vital testimony was after the Commissioner had ruled that the evidence adduced before him was insufficient (R. 9–10).

In the third place, the bare and unexplained facts of the transaction merely show a sale in December 1928 and a reacquisition the following year. Unexplained by other facts, the Commissioner is justified in asserting that the sale and reacquisition was part of one transaction. The evidence merely shows a movement of taxpayer's stock from her to her father and back to her again. Insofar as the record shows no loss was actually sustained by the taxpayer on the whole transaction. Cf. *United States* v. *Flannery,* 268 U. S. 98. In *Shoenberg* v. *Commissioner,* 77 F. (2d) 446 (C. C. A. 8th), the court said (p. 449):

> The place of a sale in claiming a deduction is as evidence that a loss has been realized. If the sale is real and is an isolated transaction, it is conclusive proof. If it is only part of an entire plan, then the entire plan is examined to ascertain whether its effect is to produce a loss or a realized loss. * * *
>
> To secure a deduction, the statute requires that an actual loss be sustained. An actual loss is not sustained unless when the entire transaction is concluded the taxpayer is poorer to the extent of the loss claimed; in other words, he has that much less than before.
>
> A loss as to particular property is usually realized by a sale thereof for less than it cost. However, where such sale is made as part of a plan whereby substantially identical property is to be reacquired and that plan is carried out, the realization of loss is not genuine and substantial; it is not real. This is true because the taxpayer has not actually changed his position and is no poorer than before the sale. The particular sale may be real, but the entire transaction prevents the

> loss from being actually suffered. Taxation is concerned with realities, and no loss is deductible which is not real.

Cf. *Esperson* v. *Commissioner,* 49 F. (2d) 259 (C. C. A. 5th), certiorari denied, 284 U. S. 658. The doctrine that a vendor must completely sever his ownership over property in order to realize a loss upon the sale thereof has long been the rule before the Board. *M. I. Stewart & Co.* v. *Commissioner,* 2 B. T. A. 737, 739.

CONCLUSION

We submit that the decision of the Board of Tax Appeals is clearly erroneous and should be reversed.

Respectfully submitted.

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OCTOBER 1935.

APPENDIX

Revenue Act of 1928, c. 852, 45 Stat. 791:

Sec. 22. Gross Income.

(a) *General definition.*—" Gross income " includes gains, profits, and income derived from salaries, wages, or compensation for personal service, of whatever kind and in whatever form paid, or from professions, vocations, trades, businesses, commerce, or sales, or dealings in property, whether real or personal, growing out of the ownership or use of or interest in such property; also from interest, rent, dividends, securities, or the transaction of any business carried on for gain or profit, or gains or profits and income derived from any source whatever.

Sec. 23. Deductions from Gross Income.

In computing net income there shall be allowed as deductions:

* * * * *

(e) *Losses by individuals.*—In the case of an individual, losses sustained during the taxable year and not compensated for by insurance or otherwise—

(1) if incurred in trade or business; or

(2) if incurred in any transaction entered into for profit, though not connected with the trade or business; or

(3) of property not connected with the trade or business, if the loss arises from fires, storms, shipwreck, or other casualty, or from theft.

SEC. 118. LOSS ON SALE OF STOCK OR SECURITIES.

In the case of any loss claimed to have been sustained in any sale or other disposition of shares of stock or securities where it appears that within thirty days before or after the date of such sale or other disposition the taxpayer has acquired (otherwise than by bequest or inheritance) or has entered into a contract or option to acquire substantially identical property, and the property so acquired is held by the taxpayer for any period after such sale or other disposition, no deduction for the loss shall be allowed under section 23 (e) (2) of this title; nor shall such deduction be allowed under section 23 (f) unless the claim is made by a corporation, a dealer in stocks or securities, and with respect to a transaction made in the ordinary course of its business. If such acquisition or the contract or option to acquire is to the extent of part only of substantially identical property, then only a proportionate part of the loss shall be disallowed.

Treasury Regulations 74, promulgated under the Revenue Act of 1928:

ART. 171. *Losses.*—Losses sustained by individuals during the taxable year and not compensated for by insurance or otherwise are fully deductible (except by nonresident aliens, see section 213 and article 1051) if—

(a) Incurred in a taxpayer's trade or business, or

(b) Incurred in any transaction entered into for profit, or

(c) Arising from fires, storms, shipwreck, or other casualty, or theft.

Losses sustained by corporations during the taxable year and not compensated for by insurance or otherwise are deductible.

Losses must usually be evidenced by closed and completed transactions. * * *

Art. 174. *Shrinkage in value of stocks.*—A person possessing stock of a corporation cannot deduct from gross income any amount claimed as a loss merely on account of shrinkage in value of such stock through fluctuation of the market or otherwise. The loss allowable in such cases is that actually suffered when the stock is disposed of. If stock of a corporation becomes worthless, its cost or other basis determined under section 113 may be deducted by the owner in the taxable year in which the stock became worthless, provided a satisfactory showing of its worthlessness be made, as in the case of bad debts. * * *

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